



## **OSI Geospatial Inc.**

**Interim Consolidated Financial Statements (Unaudited)  
Three Months Ended February 28, 2010 and 2009  
(expressed in Canadian dollars)**

(Prepared in accordance with Canadian Generally Accepted Accounting Principles)

# OSI Geospatial Inc.

(Incorporated under the laws of the Province of British Columbia, Canada)

## Interim Consolidated Balance Sheets (Unaudited)

In thousands of Canadian dollars	February 28, 2010	November 30, 2009
<b>Assets</b>		
<b>Current assets</b>		
Cash and cash equivalents	\$ 2,852	\$ 315
Restricted cash	263	-
Accounts receivable and unbilled revenue	4,832	5,880
Inventory (note 5)	1,053	1,139
Prepaid expenses and deposits	480	375
Current portion of future income tax asset	181	1,041
	9,661	8,750
<b>Restricted cash</b>	373	-
<b>Deferred development costs</b>	546	653
<b>Future income tax asset</b>	80	113
<b>Equipment and furnishings</b>	1,334	1,473
<b>Intangible and other assets</b>	380	446
<b>Goodwill</b>	4,305	4,324
	\$ 16,679	\$ 15,759
<b>Liabilities</b>		
<b>Current liabilities</b>		
Bank indebtedness	\$ -	\$ 599
Factored advances payable (note 4)	74	240
Accounts payable and accrued liabilities	2,637	3,806
Income taxes payable	1,068	-
Unearned revenue	279	550
Current portion of deferred rent	41	41
Current portion of capital lease obligation	54	68
	4,153	5,304
<b>Deferred rent</b>	249	260
<b>Capital lease obligation</b>	48	54
<b>Unearned revenue</b>	150	178
	4,600	5,796
<b>Contingency (note 10)</b>		
<b>Shareholders' Equity</b>		
Issued and outstanding		
Class A, Series A preference shares	30	30
Class B, Series 2 preference shares (note 6a)	3,237	5,383
Common shares (note 6a)	30,769	29,876
	34,036	35,289
<b>Warrants (note 6b)</b>	4,546	4,546
<b>Contributed surplus (note 6a)</b>	4,603	3,322
<b>Accumulated deficit</b>	(29,759)	(31,838)
<b>Accumulated other comprehensive loss</b>	(1,347)	(1,356)
	12,079	9,963
	\$ 16,679	\$ 15,759

The accompanying notes are an integral part of the interim consolidated financial statements.

# OSI Geospatial Inc.

## Interim Consolidated Statements of Income (Loss) and Deficit (Unaudited)

In thousands of Canadian dollars, except share related data	Three months ended February 28,	
	2010	2009
<b>Revenue</b>		
Maritime navigation and tactical solutions	\$ 1,406	\$ 3,522
Advanced technology research and development	1,924	1,943
Mapping	114	259
	<u>3,444</u>	<u>5,724</u>
<b>Cost of sales</b>	<u>2,338</u>	<u>4,005</u>
<b>Gross profit</b>	<u>1,106</u>	<u>1,719</u>
<b>Expenses (income)</b>		
General and administrative	1,267	1,209
Sales and marketing	665	813
Engineering	176	301
Amortization	87	113
Interest expense	38	31
Foreign exchange gain	(10)	-
Technology Partnerships Canada royalty	69	96
	<u>2,292</u>	<u>2,563</u>
<b>Net loss before other items</b>	<u>(1,186)</u>	<u>(844)</u>
Gain on sale of intellectual property (note 11)	5,227	-
<b>Net income (loss) before income taxes</b>	<u>4,041</u>	<u>(844)</u>
Future income tax (recovery)	888	(152)
Current income tax expense	1,071	5
<b>Income tax expense (recovery)</b>	<u>1,959</u>	<u>(147)</u>
<b>Net income (loss)</b>	<u>2,082</u>	<u>(697)</u>
Accumulated deficit, beginning of period	(31,838)	(24,121)
Dividends on Class B preference shares	(3)	(3)
<b>Accumulated deficit, end of period</b>	<u>\$ (29,759)</u>	<u>\$ (24,821)</u>
<b>Net income (loss) attributable to common shareholders</b> (note 6d)		
Basic	\$ 1,951	\$ (853)
Diluted	2,082	(853)
<b>Earnings (loss) per share</b> (note 6d):		
Basic	\$ 0.04	\$ (0.02)
Diluted	0.04	(0.02)
<b>Weighted average number of common shares outstanding</b> (note 6d):		
Basic	48,733,766	46,956,439
Diluted	57,659,553	46,956,439

The accompanying notes are an integral part of the interim consolidated financial statements.

## OSI Geospatial Inc.

### Interim Consolidated Statements of Comprehensive Income (Loss) (Unaudited)

In thousands of Canadian dollars	<b>Three months ended February 28,</b>	
	<b>2010</b>	<b>2009</b>
<b>Net income (loss)</b>	\$ 2,082	\$ (697)
<b>Other comprehensive income, net of taxes</b>		
Unrealized gain on translation of self-sustaining foreign operations	9	361
<b>Comprehensive income (loss)</b>	<u>\$ 2,091</u>	<u>\$ (336)</u>

## OSI Geospatial Inc.

### Interim Consolidated Statements of Accumulated Other Comprehensive Income (Loss) (Unaudited)

In thousands of Canadian dollars	<b>Three months ended February 28,</b>	<b>Year ended November 30,</b>
	<b>2010</b>	<b>2009</b>
Accumulated other comprehensive income (loss), beginning of the period	\$ (1,356)	\$ 631
Unrealized gain (loss) on translating financial statements of self-sustaining foreign operations	9	(1,987)
<b>Accumulated other comprehensive loss, end of period</b>	<u>\$ (1,347)</u>	<u>\$ (1,356)</u>

The accompanying notes are an integral part of the interim consolidated financial statements.

# OSI Geospatial Inc.

## Interim Consolidated Statements of Cash Flows (Unaudited)

In thousands of Canadian dollars	Three months ended February 28,	
	2010	2009
<b>Cash flows from (used in) operating activities</b>		
Net income (loss) for the period	\$ 2,082	\$ (697)
Items not affecting cash		
Amortization	124	161
Gain on disposal of intellectual property	(5,227)	-
Stock-based compensation	28	-
Future income taxes	888	(152)
	<u>(2,105)</u>	<u>(688)</u>
Changes in non-cash operating working capital items		
Accounts receivable	1,036	2,014
Inventory	86	356
Prepaid expenses and deposits	(103)	(220)
Accounts payable and accrued liabilities	(1,164)	(1,331)
Income taxes payable	1,070	5
Deferred rent	(10)	(10)
Unearned revenue	(299)	10
	<u>616</u>	<u>824</u>
	<u>(1,489)</u>	<u>136</u>
<b>Cash flows from (used in) investing activities</b>		
Increase in restricted cash	(638)	-
Development costs deferred	(25)	(18)
Additions to equipment and furnishings	(10)	(30)
Additions to intangibles and other assets	-	(2)
Proceeds from disposal of intellectual property and related tangible assets, net of costs to dispose	5,444	-
	<u>4,771</u>	<u>(50)</u>
<b>Cash flows used in financing activities</b>		
Repayment of bank indebtedness	(599)	(66)
Factored advances payable	(165)	-
Repayment of capital lease obligation	(20)	(14)
Class B preference share dividends declared and paid	(3)	(3)
	<u>(787)</u>	<u>(83)</u>
<b>Effect of foreign exchange on cash balances</b>	<u>42</u>	<u>(3)</u>
<b>Increase in cash and cash equivalents</b>	<u>2,537</u>	<u>-</u>
<b>Cash and cash equivalents – beginning of period</b>	<u>315</u>	<u>-</u>
<b>Cash and cash equivalents – end of period</b>	<u>\$ 2,852</u>	<u>\$ -</u>
Supplemental cash flow information:		
Cash interest paid	\$ (43)	\$ (30)
Cash income taxes paid	(1)	-

The accompanying notes are an integral part of the interim consolidated financial statements.

# OSI Geospatial Inc.

## Notes to the Interim Consolidated Financial Statements (Unaudited)

Three Months Ended February 28, 2010 and 2009

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### 1 Basis of presentation

These unaudited interim consolidated financial statements have been prepared by management and include the accounts of OSI Geospatial Inc. and its subsidiaries, collectively referred to as OSI Geospatial or the Company. These unaudited interim consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles ("Canadian GAAP") and all amounts have been expressed in Canadian dollars unless otherwise noted.

These unaudited interim consolidated financial statements have been prepared using the same accounting policies used in the preparation of the audited annual consolidated financial statements for the year ended November 30, 2009.

These unaudited interim consolidated financial statements do not include all the information and footnote disclosures required by Canadian GAAP for annual audited consolidated financial statements. These unaudited interim consolidated financial statements should be read in conjunction with the Company's audited annual consolidated financial statements.

The preparation of these unaudited interim consolidated financial statements requires management to make estimates and assumptions that affect the amounts reported. Actual results could vary from these estimates and the operating results for the interim periods presented are not necessarily indicative of the results expected for the full year.

These unaudited interim consolidated financial statements are prepared on a going-concern basis, which assumes that the Company will continue in operation for the foreseeable future and be able to realize its assets and discharge its liabilities and commitments in the normal course of business. Certain conditions and uncertainties cast doubt about the validity of this assumption. The Company has a history of recurring losses and has an accumulated deficit of \$30 million. In October 2009, the Company replaced its U.S. line of credit with an accounts receivable factoring arrangement to support its U.S. working capital requirements. In January 2010, the Company replaced its Canadian line of credit with an accounts receivable factoring arrangement to support its Canadian working capital requirements. As per note 11, on February 1, 2010, the Company sold its soldier systems intellectual property for U.S. \$6.5 million. The net proceeds after corporate income taxes are approximately U.S. \$5.5 million with approximately U.S. \$5.0 million paid in February 2010 and the balance to be paid in fiscal 2011. The net proceeds provided additional working capital for the Company. The Company expects that its level of working capital should be sufficient to fund future operations for a period greater than twelve months.

The ability of the Company to continue as a going concern and meet its commitments and ongoing operating expenses is dependent on achieving profitable operations, and/or obtaining necessary levels of financing. There is no assurance that the Company will be successful in achieving these goals.

These unaudited interim consolidated financial statements do not include any adjustments to the carrying value of assets and liabilities, and changes to balance sheet classifications that might be necessary should the Company not continue as a going concern and these adjustments and reclassifications could be material.

# OSI Geospatial Inc.

## Notes to the Interim Consolidated Financial Statements (Unaudited) Three Months Ended February 28, 2010 and 2009

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### 2 Accounting Changes

#### Recent pronouncements

The following recent pronouncements issued by the Canadian Institute of Chartered Accountants (CICA) will be monitored by the Company:

The CICA has issued CICA Handbook Section 1582, *Business Combinations*, which replaces CICA Handbook Section 1581, *Business Combinations*. This Section establishes standards for the recognition, measurement, presentation and disclosure of business combinations. This Section applies to annual and interim financial statements relating to fiscal years beginning on or after January 1, 2011. Accordingly, the Company plans to adopt the new Section for its fiscal year beginning December 1, 2011. The Company does not expect that the adoption of this new Section will have a material impact on its consolidated financial statements.

The CICA has issued CICA Handbook Section 1601, *Consolidated Financial Statements*, and CICA Handbook Section 1602, *Non-controlling Interests*, which replace CICA Handbook Section 1600, *Consolidated Financial Statements*. CICA Handbook Section 1601 establishes standards for the preparation of consolidated financial statements and CICA Handbook Section 1602 establishes standards for accounting for a non-controlling interest in a subsidiary in consolidated financial statements. These Sections apply to annual and interim financial statements relating to fiscal years beginning on or after January 1, 2011. Accordingly, the Company plans to adopt the new Section for its fiscal year beginning December 1, 2011. The Company does not expect that the adoption of this new Section will have a material impact on its consolidated financial statements.

The CICA has issued EIC 175, *Multiple Deliverable Revenue Arrangements*, which addresses how to determine whether an arrangement involving multiple deliverables contains more than one unit of accounting. This abstract also addresses how arrangement consideration should be measured and allocated to the separate units of accounting in the arrangement. EIC 175 applies to revenue arrangements with multiple deliverables entered into or materially modified in the first annual fiscal period beginning on or after January 1, 2011. Accordingly, the Company plans to adopt the new Section for its fiscal year beginning December 1, 2011. The Company does not expect that the adoption of this standard will have a material impact on its consolidated financial statements.

The Canadian Accounting Standards Board has confirmed that the use of International Financial Reporting Standards ("IFRS") will be required commencing 2011 for publicly accountable, profit oriented enterprises. IFRS will be replacing current Canadian GAAP followed by the Company. The Company will be required to begin reporting under IFRS for its fiscal year ended November 30, 2012 and will be required to provide information that conforms to IFRS for the comparative periods presented. The Company is currently evaluating the impact of adopting IFRS.

### 3 Nature of operations

OSI Geospatial delivers integrated navigation and tactical solutions that meet naval and maritime security operational requirements. These solutions include our Warship Electronic Chart Display and Information System (ECPINS®-W/S), Tactical Asset Control and Tracking System (TACTS), Integrated Navigation and Tactical System (INTS) and security risk assessment consulting services. In addition, OSI Geospatial provides advanced technology research and development engineering services in support of the military and security requirements and mapping services that provide geospatial data production and consulting services. OSI Geospatial conducts its operations through three business units – International Systems, U.S. Systems and Mapping.

# OSI Geospatial Inc.

## Notes to the Interim Consolidated Financial Statements (Unaudited) Three Months Ended February 28, 2010 and 2009

### 4 Credit facilities

In January 2010, the Company moved its Canadian credit facilities to another Canadian financial institution. The financing agreement consists of accounts receivable factoring arrangements.

At February 28, 2010, the Company had total borrowing capacity under its Canadian accounts receivable factoring arrangement of \$2.0 million. Under the terms of the factoring agreement, the Company may be requested to repay any amounts owing plus applicable interest. The fees charged under this agreement are a) discount equal to discount percentage as set forth in the applicable schedule; b) 18.25% interest on any receivables that are required to be repurchased, payable from the designated due date until payment is made; and c) per diem equal to discount factor as set forth in the applicable schedule for any receivable not collected, payable from the designated due date until full payment of receivable is received. The financial institution is not entitled to both the interest and the per diem on any given day in respect of the same receivable. The credit facility is secured by a general assignment of accounts covering substantially all of the Company's present and future Canadian accounts receivable, claims and interests. This arrangement is being recorded as a financing from the factoring company and factoring costs are being charged to operations as incurred. At February 28, 2010, the amount advanced under this facility was \$nil (November 30, 2009 – \$nil).

In October 2009, the Company's subsidiary, CHI Systems Inc. ("CHI"), entered into accounts receivable factoring arrangements with a U.S. financial institution. Under the terms of the factoring agreement, CHI shall repurchase the accounts that remain unpaid because of certain events as specified in the agreement. Fees charged under this agreement are a servicing fee of 0.275% for the first 15 days, 0.293% after 15 days and a daily discount fee of 0.0132%. The daily discount fee is the prime rate as published in *The Wall Street Journal* on the purchase date plus 1.5% per annum. This arrangement is being recorded as a financing from the factoring company and factoring costs are being charged to operations as incurred. The facility is secured by a security agreement covering substantially all of CHI's present and future property and interests. At February 28, 2010, the amount advanced under this facility was \$74,000 (November 30, 2009 – \$240,000).

The Company has a foreign exchange facility with a Canadian chartered bank whereby it can enter into forward foreign exchange contracts. The maximum facility is based on a bank formula for deemed risk and is calculated using recent volatility in the currency of the contract as well as the length of the contract. At February 28, 2010, the foreign exchange facility would enable the Company to enter into U.S. dollar denominated forward foreign exchange contracts for approximately \$9 million (November 30, 2009 - \$9 million). This facility is insured through insurance solutions provided by Export Development Canada. As at February 28, 2010, the Company has drawn on its forward foreign exchange contract facility in the amount of \$894,000 (November 30, 2009 - \$918,000). A foreign exchange gain on these contracts of \$56,000 and a foreign exchange loss of \$8,000 was recognized at February 28, 2010 and November 30, 2009, respectively.

### 5 Inventory

In thousands of Canadian dollars

	February 28, 2010	November 30, 2009
Materials and components	\$ 825	\$ 806
Work-in-process	45	150
Finished goods	183	183
	<u>\$ 1,053</u>	<u>\$ 1,139</u>

The cost of inventories recognized as expense and included in cost of sales for the three months ended February 28, 2010 was \$100,000 (three months ended February 28, 2009 - \$848,000).

# OSI Geospatial Inc.

## Notes to the Interim Consolidated Financial Statements (Unaudited) Three Months Ended February 28, 2010 and 2009

### 6 Capital stock

#### a) Class B series 2 preference shares and common shares

During the three months ended February 28, 2010, 66,861 Class B series 2 preference shares (2009 – nil) were converted into 3,932,999 common shares. Accordingly, the Class B series 2 preference shares were reduced by \$2,146,000, the carrying value of the shares converted. The common shares were increased by \$893,000 and the contributed surplus was increased by \$1,253,000.

#### b) Warrants

On July 31, 2009, 2,780,000 common share purchase warrants, which were valued at \$352,000 using the Black-Scholes option pricing model, expired. Accordingly, the Company has reduced warrants by \$352,000 with a corresponding increase to contributed surplus.

#### c) Stock option plans

A summary of the outstanding and exercisable options of the Company's stock option plan at February 28, 2010 is as follows:

In Canadian dollars		
	Number of shares	Weighted average exercise price
Outstanding at November 30, 2009	4,153,166	\$ 0.65
Granted	525,000	0.23
Forfeited	(380,750)	0.48
Surrendered	(510,333)	0.91
Outstanding at February 28, 2010	3,787,083	\$ 0.57
Exercisable at February 28, 2010	3,003,739	\$ 0.67

#### Stock-based compensation

For the three months ended February 28, 2010, the Company incurred non-cash stock-based compensation expense of \$28,000 (three months ended February 28, 2009 - \$nil) related to 525,000 stock options granted during the quarter ended February 28, 2010 and 1,275,000 stock options granted during the year ended November 30, 2009. Of the stock options granted during the quarter ended February 28, 2010, 175,000 vested immediately, 175,000 will vest over one year and 175,000 will vest over two years from the grant date. Of the stock options granted during the year ended November 30, 2009, 809,000 vested immediately, 233,000 will vest over one year and 233,000 will vest over two years from the grant date. The expense was included in general and administrative costs and the offsetting amount was recorded in contributed surplus. The weighted average fair value of the stock options at grant date is \$0.12 per stock option (2009 - \$0.07).

# OSI Geospatial Inc.

## Notes to the Interim Consolidated Financial Statements (Unaudited) Three Months Ended February 28, 2010 and 2009

### d) Earnings (loss) per share

In thousands of Canadian dollars, except share related data	For the three months ended February 28,	
Earnings (loss) per share – basic	2010	2009
Net income (loss) for the period	\$ 2,082	\$ (697)
Less:		
Class B Series 2 preference share dividends (*A)	(131)	(156)
Net income (loss) available to common shareholders	\$ 1,951	\$ (853)
Weighted average number of common shares outstanding – basic	48,733,766	46,956,439
Earnings (loss) per share – basic	\$ 0.04	\$ (0.02)

(\*A) Dividends of \$131,000 (2009 - \$156,000) are included which represents the dividends earned by the shareholders of Class B Series 2 cumulative preference shares. As at February 28, 2010, there were \$1,351,000 (November 30, 2009 - \$1,219,000) of dividends in arrears for the Class B Series 2 cumulative preference shares.

In thousands of Canadian dollars, except share related data	For the three months ended February 28,	
Earnings (loss) per share – diluted	2010	2009
Net income (loss) for the period	\$ 2,082	\$ (697)
Less:		
Class B Series 2 preference share dividends (*A)	-	(156)
Net income (loss) available to common shareholders	\$ 2,082	\$ (853)
Weighted average number of common shares outstanding	48,733,766	46,956,439
Dilutive effect of Class A, Series A preference shares (*C)	30,262	-
Dilutive effect of Class B, Series 2 preference shares (*C)	8,799,431	-
Dilutive effect of warrants (*B) (*C)	-	-
Dilutive effect of stock options (*B) (*C)	96,094	-
Adjusted weighted average number of common shares outstanding – diluted	57,659,553	46,956,439
Earnings (loss) per share – diluted	\$ 0.04	\$ (0.02)

(\*A) Dividends of \$nil (2009 - \$156,000) are included which represents the dividends earned by the shareholders of Class B Series 2 cumulative preference shares. As at February 28, 2010, there were \$1,351,000 (November 30, 2009 - \$1,219,000) of dividends in arrears for the Class B Series 2 cumulative preference shares.

(\*B) The outstanding warrants and some stock options that were outstanding at February 28, 2010 were not included in the calculation of diluted earnings per share because the exercise price of warrants and stock options were greater than the average market price of the common shares.

(\*C) The outstanding preferred shares, warrants and stock options were anti-dilutive for the purposes of calculating diluted loss per share for the three months ended February 28, 2009.

# OSI Geospatial Inc.

## Notes to the Interim Consolidated Financial Statements (Unaudited) Three Months Ended February 28, 2010 and 2009

If all preferred shares were converted, and all warrants and options were exercised, there would be a total of 73,746,610 common shares outstanding at February 28, 2010 (November 30, 2009 – 76,093,696). As a result of the exercise of all warrants and options, the Company would receive cash of \$12.7 million (November 30, 2009 - \$13.2 million).

### 7 Financial instruments

The Company has exposure to the following risks from its use of financial instruments: credit, market and liquidity risks. The Company reviews its risk management framework on a quarterly basis and makes adjustments as necessary.

#### Credit risk

Credit risk is the risk of financial loss to the Company if a customer or counterparty to a financial instrument fails to meet its contractual obligations. Credit risk arises principally from the Company's cash and cash equivalents, accounts receivable and its foreign exchange contracts. The Company provides credit to its customers in the normal course of its operations. The Company's credit risk review includes performing credit evaluations of the financial condition of significant customers. The Company's customers are for the most part national and international government clients and large public customers. A significant portion of the Company's accounts receivable is from long-time customers and at February 28, 2010, 84% (November 30, 2009 – 62%) of its accounts receivable was with national and international government clients and 4% (November 30, 2009 – 20%) of its accounts receivable was with large international public companies. Due to the low risk nature of the government clients and a history of excellent collections, provisions for doubtful accounts are made on a customer-by-customer basis, based on ongoing customer discussions.

The Company is exposed to non-performance by counterparties to foreign currency forward contracts. These counterparties are major financial institutions and to date, no such counterparty has failed to meet its financial obligations to the Company. Management does not believe there is a significant risk of non-performance by these counterparties because the positions with and the credit rating of these counterparties are monitored.

The carrying amount of financial assets represents the maximum credit exposure. The maximum exposure to credit risk at the reporting date was:

In thousands of Canadian dollars

	<b>February 28, 2010</b>	<b>November 30, 2009</b>
Cash and cash equivalents	\$ 2,852	\$ 315
Restricted cash	636	-
Trade accounts receivable	2,474	2,607
Unbilled revenue	2,124	3,164
Other	244	119
Allowance for doubtful accounts	(10)	(10)
	<b>\$ 8,320</b>	<b>\$ 6,195</b>

# OSI Geospatial Inc.

## Notes to the Interim Consolidated Financial Statements (Unaudited) Three Months Ended February 28, 2010 and 2009

The aging of the trade accounts receivable at the reporting date was:

In thousands of Canadian dollars

	February 28, 2010	November 30, 2009
Current	\$ 2,054	\$ 2,401
Past due (61 – 90 days)	52	33
Past due greater than 90 days	368	173
	<u>\$ 2,474</u>	<u>\$ 2,607</u>

Based on historic default rates, the Company believes that there are minimal requirements for an allowance for doubtful accounts.

### Market risk

Market risk is the risk that changes in market prices, such as foreign exchange rates and interest rates, will affect the Company's income or the value of its holding of financial instruments.

#### *Foreign exchange risk*

The Company operates internationally, giving rise to exposure to market risks from changes in foreign exchange rates. The Company is exposed to foreign currency fluctuations mainly on its accounts receivable and future cash flows related to contracts denominated in a foreign currency. The Company's foreign exchange risk management includes the use of foreign currency forward contracts to fix the exchange rates on certain foreign currency exposures. The Company's objective is to manage and control exposures and secure the Company's profitability on existing contracts and, therefore, the Company's policy is to hedge the majority of its foreign currency exposure. The Company does not utilize derivative financial instruments for trading or speculative purposes. The Company formally documents all relationships between derivative financial instruments and hedged items, as well as its risk management objective and strategy for undertaking various hedge transactions. This process includes linking all derivatives to specific firm contractually related commitments on projects.

The Company did not designate its foreign exchange forward contracts as a hedge of underlying assets, liabilities, firm commitments or anticipated transactions in accordance with CICA Handbook Section 3865, *Hedges*, and accordingly, did not use hedge accounting. As a result of this, the foreign exchange forward contracts are recorded on the consolidated balance sheet at fair value in other receivables when the contracts are in a gain position and in other accrued liabilities when the contracts are in a loss position. The fair value of the foreign exchange forward contracts was a recorded asset in other receivables of \$56,000 at February 28, 2010 and was a recorded liability in accounts payable and accrued liabilities of \$8,000 at November 30, 2009. Changes in fair value of these contracts are recognized as gains or losses in the consolidated statement of operations.

# OSI Geospatial Inc.

## Notes to the Interim Consolidated Financial Statements (Unaudited) Three Months Ended February 28, 2010 and 2009

The forward foreign exchange contracts primarily require the Company to sell certain foreign currencies for Canadian dollars at contractual rates. The Company had the following forward foreign exchange contracts:

In thousands of dollars				February 28, 2010	
Type	Notional	Currency	Maturity	Equivalent to Canadian Dollars	Fair Value
Sell	192	GBP	April 2010	336	\$ 29
Sell	51	USD	April 2010	54	-
Sell	120	EURO	April 2010	188	16
Sell	100	GBP	May 2010	168	8
Sell	100	EURO	May 2010	147	3
					<u>\$ 56</u>

In thousands of dollars				November 30, 2009	
Type	Notional	Currency	Maturity	Equivalent to Canadian Dollars	Fair Value
Sell	200	GBP	April 2010	350	\$ -
Sell	120	USD	April 2010	127	-
Sell	163	EURO	February 2010	253	(6)
Sell	120	EURO	April 2010	188	(2)
					<u>\$ (8)</u>

A 10% strengthening (weakening) of the Canadian dollar against each of the Great Britain pound, the U. S. dollar, the Euro and the Australian dollar would have decreased (increased) earnings from operations at February 28, 2010 by a total of \$15,000 (November 30, 2009 – \$5,000). A 10% strengthening (weakening) of the Canadian dollar against the U.S. dollar would have decreased (increased) the reporting currency earnings from U.S. operations for the three months ended February 28, 2010 by a total of \$473,000 (the year ended November 30, 2009 – \$51,000). A 10% strengthening (weakening) of the Canadian dollar against the U.S. dollar would impact the reporting currency balance sheet values at February 28, 2010 with an offsetting loss (gain) of approximately \$832,000 (November 30, 2009 – \$1,183,000) to other comprehensive income.

### *Interest rate risk*

The Company is exposed to interest rate risk on its operating line of credit. A 1% increase (decrease) in the interest rate would have resulted in \$1,000 increase (decrease) in the loss of the Company for this quarter.

### **Liquidity risk**

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they fall due. The Company's approach to managing liquidity risk is to ensure that it will always have sufficient liquidity to meet liabilities when due. The Company has an accounts receivable factoring credit facility of \$2.0 million in Canada and a variable limit in the U.S. that is based on the outstanding accounts receivable of the U.S. operations. At February 28, 2010, the Company utilized \$nil (November 30, 2009 – \$nil) and U.S. \$71,000 (November 30, 2009 – U.S. \$227,000). As at November 30, 2009, the Company has operating line of credit facility of \$1 million in Canada and utilized \$860,000. All of the Company's financial liabilities, other than capital lease obligations, have contractual maturities of less than 45 days.

# OSI Geospatial Inc.

## Notes to the Interim Consolidated Financial Statements (Unaudited) Three Months Ended February 28, 2010 and 2009

The table below analyzes the following liabilities which will settle as indicated based on the remaining periods at February 28, 2010 to the contractual maturity date. The amounts disclosed in this table are the contractual undiscounted cash flows. Balances within twelve months equal the carrying balance as the impact of discounting is not significant.

<b>Payments due by period</b>	<b>Total</b>	<b>Less than 1 year</b>	<b>1 to 3 years</b>	<b>4 to 5 years</b>	<b>After 5 years</b>
In thousands of Canadian dollars					
Facility leases	\$ 2,967	\$ 761	\$ 1,156	\$ 510	\$ 540
Capital equipment leases	113	61	52	-	-
Operating equipment leases	43	31	12	-	-
<b>Total contractual obligations</b>	<b>\$ 3,123</b>	<b>\$ 853</b>	<b>\$ 1,220</b>	<b>\$ 510</b>	<b>\$ 540</b>

### Fair values

#### a) Establishing fair value

The Company's financial instruments consist of cash, bank indebtedness, accounts receivable, accounts payable and accrued liabilities, factored advances payable, capital lease obligations, and foreign exchange contracts. The carrying value of cash and cash equivalents, bank indebtedness, accounts receivable, accounts payable and accrued liabilities, and factored advances payable approximates their fair value due to the immediate or short-term maturity of these financial instruments.

The fair values of the Company's forward foreign exchange contracts are based on the current market values of similar contracts with the same remaining duration as if the contracts had been entered into on February 28, 2010 and November 30, 2009.

The carrying amounts of each of the financial instruments are:

In thousands of Canadian dollars

	<b>February 28, 2010</b>	<b>November 30, 2009</b>
Held-for-trading		
Cash	\$ 2,852	\$ 315
Restricted cash	636	-
Forward contracts	56	(8)
Loans and receivables		
Trade accounts receivable	2,474	2,607
Other liabilities		
Bank indebtedness	-	(599)
Factored advances payable	(74)	(240)
Accounts payable and accrued liabilities	(2,637)	(3,806)
Capital lease obligation	(102)	(122)

# OSI Geospatial Inc.

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### b) Fair-value hierarchy

Financial instruments recorded at fair value on the consolidated balance sheet are classified using the fair-value hierarchy that reflects the significance of the inputs used in making the measurements. The fair-value hierarchy has the following levels:

Level 1 – valuation based on quoted prices (unadjusted) in active markets for identical assets or liabilities;

Level 2 – valuation techniques based on inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly (i.e., as prices) or indirectly (i.e., derived from prices); and

Level 3 – valuation techniques using inputs for the asset or liability that are not based on observable market data (unobservable inputs).

The fair-value hierarchy requires the use of observable market inputs whenever such inputs exist. A financial instrument is classified to the lowest level of the hierarchy for which a significant input has been considered in measuring fair value.

The following table presents the fair value of the financial instruments that are carried at fair value classified using the fair-value hierarchy described above:

In thousands of Canadian dollars	February 28, 2010			
	Level 1	Level 2	Level 3	Total
Financial assets				
Forward foreign exchange contracts	\$ -	\$ 56	\$ -	\$ 56
Total financial assets	\$ -	\$ 56	\$ -	\$ 56
In thousands of Canadian dollars	November 30, 2009			
	Level 1	Level 2	Level 3	Total
Financial liabilities				
Forward foreign exchange contracts	\$ -	\$ (8)	\$ -	\$ (8)
Total financial liabilities	\$ -	\$ (8)	\$ -	\$ (8)

## 8 Capital structure management

The Company's objective is to maintain a strong capital base so as to maintain investor, creditor and market confidence and to sustain future development of the business. The Company reviews on a semi-annual basis whether any dividends should be paid.

The Company monitors capital on a basis consistent with others in the industry based on total debt to shareholders' equity. Management defines capital as the Company's total shareholders' equity, excluding accumulated other comprehensive income and total debt, is defined as bank indebtedness and capital lease obligations.

There were no changes in the Company's approach to capital management during the period. Neither the Company nor any of its subsidiaries is subject to externally imposed capital requirements other than disclosed in note 4.

# OSI Geospatial Inc.

## Notes to the Interim Consolidated Financial Statements (Unaudited) Three Months Ended February 28, 2010 and 2009

In thousands of Canadian dollars

	February 28, 2010	November 30, 2009
Bank indebtedness	\$ -	\$ 599
Factored advances payable	74	240
Capital lease obligation	101	122
Total debt	<u>\$ 175</u>	<u>\$ 961</u>
Total equity	12,079	9,963
Less accumulated other comprehensive loss	1,347	1,356
Net equity	<u>\$ 13,426</u>	<u>\$ 11,319</u>

### 9 Segmented information

The Company operates in four segments: International Systems Operations, U.S. Systems Operations, Mapping Operations and Corporate and public company costs. Operating segments are identified as components of the Company for which separate discrete financial information is available for evaluation by the chief operating decision maker regarding how to allocate resources and assess performance. The Company's chief operating decision maker is the Chief Executive Officer.

The Company's reportable segments are as outlined below which are defined by their primary type of service offerings. Information about the Company's reportable segments is as follows:

In thousands of Canadian dollars

Three Months Ended February 28, 2010

	International Systems Operations	U.S. Systems Operations	Mapping Operations	Corporate and Public Company Costs	Total
Revenue	\$ 1,215	\$ 2,115	\$ 114	\$ -	\$ 3,444
Gross profit	644	549	(87)	-	1,106
Technology Partnerships Canada – net	69	-	-	-	69
Interest expense	7	5	-	26	38
Income tax expense (recovery)	-	1,959	-	-	1,959
Amortization	46	48	24	6	124
Net income (loss)	(220)	3,060	(295)	(463)	2,082
Equipment and furnishings expenditures	-	10	-	-	10
Intangible expenditures	-	-	-	-	-

# OSI Geospatial Inc.

## Notes to the Interim Consolidated Financial Statements (Unaudited) Three Months Ended February 28, 2010 and 2009

In thousands of Canadian dollars

Three Months Ended February 28, 2009

	International Systems Operations	U.S. Systems Operations	Mapping Operations	Corporate and Public Company Costs	Total
Revenue	\$ 1,997	\$ 3,468	\$ 259	\$ -	\$ 5,724
Gross profit	1,141	584	(6)	-	1,719
Technology Partnerships Canada – net	96	-	-	-	96
Interest expense	1	16	-	14	31
Income tax expense (recovery)	-	(152)	-	5	(147)
Amortization	54	64	36	7	161
Net income (loss)	99	115	(283)	(628)	(697)
Equipment and furnishings expenditures	1	22	2	5	30
Intangible expenditures	-	2	-	-	2

In thousands of Canadian dollars

Total assets employed	International Systems Operations	U.S. Systems Operations	Mapping Operations	Corporate and Public Company Costs	Total
As at February 28, 2010	\$ 4,587	\$ 8,691	\$ 1,740	\$ 1,661	\$ 16,679
As at November 30, 2009	\$ 4,636	\$ 8,448	\$ 2,439	\$ 236	\$ 15,759

Geographically, revenues reported are based on the location of the Company's customers as follows:

In thousands of Canadian dollars

Three months ended February 28,

	2010	2009
United States	\$ 2,191	\$ 3,526
Australia	254	1,213
United Kingdom	412	512
Netherlands	122	-
Canada	96	358
New Zealand	64	63
Other	305	52
Total	\$ 3,444	\$ 5,724

# OSI Geospatial Inc.

## Notes to the Interim Consolidated Financial Statements (Unaudited)

Three Months Ended February 28, 2010 and 2009

Geographically, equipment and furnishings and intangible and other assets are reported based on location. At February 28, 2010 and November 30, 2009, all of the Company's equipment and furnishings and intangible and other assets were located in Canada and the U.S. as follows:

In thousands of Canadian dollars		February 28, 2010		
	Canada	U.S.	Total	
Equipment and furnishings	\$ 1,162	\$ 172	\$ 1,334	
Intangible and other assets	155	225	380	
Goodwill	-	4,305	4,305	
Total	\$ 1,317	\$ 4,702	\$ 6,019	

  

In thousands of Canadian dollars		November 30, 2009		
	Canada	U.S.	Total	
Equipment and furnishings	\$ 1,215	\$ 258	\$ 1,473	
Intangible and other assets	168	278	446	
Goodwill	-	4,324	4,324	
Total	\$ 1,383	\$ 4,860	\$ 6,243	

### 10 Contingency

In January 2010, a claim for breach of contract and wrongful dismissal was filed against the Company by a former employee of the Company. The Company believes the claim is without merit and the Company has filed a counterclaim for breach of fiduciary obligations as an officer of the Company and contractual obligations under the former employee's Employment Agreement. The final outcome with respect to this claim and counterclaim cannot be predicted with certainty and no amount has been accrued in the financial statements.

### 11 Sale of soldier systems intellectual property

On February 1, 2010, the Company's U.S. Systems Operations signed a contract valued at U.S. \$6.5 million with Harris Corporation ("Harris"). Under the terms of this contract, OSI Geospatial sold all of its rights to its soldier systems intellectual property and transferred its San Diego-based employees, office and associated equipment, furniture and fixtures to Harris. This intellectual property is a non-core asset that is not aligned with the Company's maritime strategy. The net proceeds after corporate income taxes were approximately U.S. \$5.5 million.

Pursuant to the terms of the contract with Harris, U.S. \$500,000 was held in escrow on behalf of the Company for the purposes of, among other things, funding the payment of any indemnification obligations of the Company. 50% of the escrow fund will be released on the first year anniversary of the closing date and the other 50% will be released upon the expiration of the escrow period in September 2011. The escrow fund is included in restricted cash in the interim consolidated balance sheet.